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INSTRUCTIONS FOR PICK-UP OF VOLUNTARY EMPLOYEE CONTRIBUTIONS

Service Purchase – Irrevocable Election

Pursuant to recent legislation, members of Montana Teachers' Retirement System (TRS) and their employers have a new tax-favored approach to purchase service or to redeposit withdrawn contributions. TRS has developed procedures to implement this new approach and has also taken the additional step of securing IRS approval for the tax-favored status and the procedures. However, the tax-favored status will only apply if the TRS procedures are followed "to the letter." Therefore, TRS has prepared these instructions that must be followed by the employer and the TRS member when an active TRS member elects to make voluntary contributions in order to purchase service or to redeposit withdrawn contributions. NOTE: These instructions do not apply to termination pay. New procedures for termination pay have been developed, but those are contained in a separate packet of information.

What is the purpose of the Pick-Up of Voluntary Employee Contributions? As employers and TRS members know, employers are currently required to pick up the mandatory 7.15% employee contribution to TRS. As a result, these mandatory contributions are not subject to state and federal income tax withholding. However, they are subject to social security taxes. Additionally, these contributions are not subject to the Internal Revenue Code Section 415 limits on contributions to TRS.

The purpose of this new pick-up is to accomplish the same result for voluntary employee contributions. Under the new legislation, a TRS member may agree to have contributions deducted from his/her compensation for a service purchase for a period of 3 to 60 months with no income tax withholding and no IRS limits on contributions. However, in this instance, the pick-up of employee contributions to purchase additional service is optional for the employer.

How does the Pick-Up work? Because the pick-up is optional for the employer, TRS has adopted a Step-by-Step approach for employers and employees to follow. This approach is the one the IRS has approved. If these steps are not followed, then TRS cannot accept the voluntary contributions on a picked-up, pre-tax basis.

Step One: The employer must adopt the attached *Model Resolution*. The signed, original Resolution must be sent to TRS. A copy of the *Model Resolution* is to be retained by the employer. This resolution has been carefully crafted to adhere to IRS requirements. It must be adopted exactly in the form presented. Beginning with the effective date of the *Model Resolution*, all payroll deductions for purchasing service must terminate until the employee has presented to the employer and the employer has accepted the *Service Purchase – Irrevocable Election Form*. The effective date stated in the resolution must be at least two months following the date the resolution is adopted by the governing body. This will ensure that the employer has time to notify all employees with payroll deduction that they need to contact TRS and request a *Service Purchase - Irrevocable Election Form*. To avoid problems, four to six month's lead-time is highly recommended.

Step Two: At the request of the member, TRS will calculate the cost of the purchasable service or redeposit. The TRS member must elect a payment schedule, which must be a minimum duration of three months but no more than 60 months. NOTE: The minimum amount of service that may be purchased is one year, or the maximum service the member is eligible to purchase, if less than one year.

Step Three: The employer and the employee must execute a *Service Purchase - Irrevocable Election Form*. The *Service Purchase – Irrevocable Election Form* may not be modified. The *Service Purchase – Irrevocable Election Form* may only take effect after the adoption of the *Model Resolution* and may only apply to contributions that would have been made after the effective date of the *Model Resolution*. For example, if the School Board adopted the *Model Resolution* with an effective date of October 1, 1999, that resolution would only apply to compensation earned with respect to services performed after October 1, 1999. It could not apply to compensation earned before that date. Therefore, the pick-up would only apply to a deduction from the compensation earned after October 1, 1999.

Step Four: The employer must send the signed, original *Service Purchase – Irrevocable Election Form* to TRS. A copy of the signed Election Form is to be retained by the employer. If TRS does not receive the *Service Purchase – Irrevocable Election Form*, TRS will not be able to appropriately credit the additional contributions.

Step Five: The employer implements the *Service Purchase – Irrevocable Election Form*, making deductions from compensation and remitting those amounts directly to TRS for the time period of the election. The employer does not subject these deductions to withholding for state and federal income tax, but does withhold and pay social security taxes on these deductions. The employer should advise the employee to consult with their plan administrator regarding any adverse impact this election may have on the employee's Tax Sheltered Annuity or Deferred Compensation Plan.

Step Six: At the end of the authorized deduction period, the employer stops the deduction. TRS will not provide any notice to the employer of this cut-off date. If contributions are continued beyond the authorized period, TRS will not be able to refund the excess contributions to the member. Corrections will have to be handled by the employer through a procedure established by TRS. This procedure will require the employer to take a credit on their next monthly TRS report or TRS will refund the excess contributions to the employer.

May the TRS member change his/her mind about the deduction? No. Once the *Service Purchase – Irrevocable Election Form* has been signed, it must be implemented for the duration of time specified. The TRS member may not accelerate payments nor may the TRS member cease or reduce payments. The only way that the deduction process ends is in the circumstance that the TRS member dies or leaves employment.

May the TRS member have more than one deduction at a time? Yes. The TRS member may execute more than one *Service Purchase – Irrevocable Election Form*, but each is independent of the other. One cannot modify the other and a member may not have an active *Service Purchase – Irrevocable Election Form* for more than one type of service in effect at the same time.

What happens if the employer does not adopt the *Model Resolution* or adopts a resolution that is different from the *Model Resolution*? If the *Model Resolution* is not adopted or the employer adopts a different resolution, TRS will not accept the contributions on a tax-deferred basis, and the employer must withhold federal and state income taxes as well as social security taxes.

Is it still possible for a TRS member to make a lump sum or installment purchase for a service purchase or repayment directly to TRS? Yes. However, TRS will apply Section 415 contribution limitations to those service purchases, which in some cases will limit the amount of the purchase. At the request of a member, TRS will provide an estimate of the lump sum amount as well as the deduction amount. Also, as noted above, once an irrevocable election is in place, the TRS member may not pre-pay any portion of the purchase unless the member terminates service or dies; in the latter case, the member, spouse or estate may pay a lump sum.

May a TRS member have deductions made for a service purchase or repayment without the pick-up in place? Yes. If the member's employer has not adopted the *Model Resolution*, the deduction is not tax-deferred. That is, the employer should withhold state and federal income taxes as well as social security taxes. In this case, amounts deducted and reported to TRS are subject to IRS 415 contribution limits.

May an employer report contributions to purchase service under both revocable and irrevocable elections? No. Once an employer has adopted the *Model Resolution* they may only withhold and report contributions to purchase service for those members who have properly executed a *Service Purchase – Irrevocable Election Form*. Members not wanting to have contributions deducted tax-deferred for the purpose of purchasing service must submit a personal check to TRS each month or as often as they wish to make payments. Payment via payroll deduction will not be available to these individuals.

What happens if the TRS member leaves the employer or dies prior to the completion of the service purchase? If no additional contributions (post-termination or death) are made, TRS will pro-rate the purchase based upon the contributions that have already been made. However, TRS will offer the member or a survivor the option to make a lump sum contribution to complete the service purchase, but the payment would be subject to the federal 415 limits on contributions. In some circumstances, these limits could mean that no additional contribution could be made.

Does making a picked-up voluntary contribution affect other contribution levels? It may. Electing to have voluntary employee contributions deducted and picked up will reduce the amount of compensation that may be included to determine the maximum an employee may contribute to a tax deferred annuity under IRC Section 403(b) or to a deferred compensation plan under IRC Section 457.